

Opinion
No. 1228

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

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DISTRICT OF COLUMBIA
TAX DIVISION

1015 15TH STREET, N.W.,
ASSOCIATES LIMITED PARTNERSHIP,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent,

NOV 13 1984

FILED

Tax Docket No. _____

3266-83

ORDER

This matter came before the Court for trial on April 24, 1983. Petitioner, the fee simple owner of property located at 1015 15th Street, N.W. (Lots 32 and 33, Square 216), challenges the real property tax assessed against it for tax year 1983 pursuant to D.C. Code §47-820 (1981). Respondent, the District of Columbia, valued the subject property for tax assessment purposes for tax year 1983 at \$18,344,320, \$6,375,820 for land and \$11,968,500 for improvements. Petitioner appealed to the Board of Equalization and Review, which increased the valuation of the improvements to \$14,151,061, resulting in a total assessment on the property of \$20,526,888. Petitioner paid the tax of \$437,222.56 and timely filed this appeal. The Court exercises jurisdiction over this appeal pursuant to D.C. Code §§47-825 and 47-3303 (1981).

FINDINGS OF FACT

1. The subject property is located at the intersection of 15th and K Streets, N.W., in the area referred to as "new downtown," that area east of 15th Street, well north of Pennsylvania Avenue, west of 7th Street and south of Massachusetts Avenue. The subject property was one of the first new commercial office buildings constructed east of 15th Street. Although there has been substantial construction

east of 15th Street since the subject property was completed, this area continues to be considered inferior to the Central Business District, and the lease rates in this area are generally lower than in the Central Business District.^{1/}

2. The subject property contains 17,468 square feet of land with primary frontage on 15th Street. The site is located in an area zoned C-4, which allows a development density of 10 "Floor Area Ratio" ("FAR"). Because the property is improved with a building which is constructed partially on leased air space over a public alley, the actual developed density is 11.26 FAR.

3. The subject property is improved with a twelve story office building, built in 1979, which is constructed on lots 32 and 33 and in the air space above a public alley which divides the two lots. For assessment purposes, the respondent attributes the entire value of the improvement to Lot 33, but values the land of the two parcels separately. Both parties agree that the current use of the property is its highest and best use.

4. The building contains 196,651 square feet of gross finished area and approximately 182,000 square feet of net rentable area.^{2/} Approximately 173,990 square feet of the net rentable area is office space, and the remaining 8,346 square feet of net rentable area is retail space. The building has below-surface parking for 145 cars.

5. From 1979 to the end of 1981, the rent for commercial office space in the District of Columbia increased from

1/ The Central Business District contains the bulk of Washington's office inventory and is centered in the area surrounding the intersection of Connecticut & L Streets, N.W.

2/ The square footage includes the area built over the public alley on leased air rights.

a \$14-16 per square foot range in 1979 to a \$22-26 square foot range in 1981.^{3/} During the same time period, the subject property was encumbered with long term leases entered into in 1979, 96% of which would not "roll-over" until 1989. Although most of the leases contain a "25% of Consumer Price Index" escalation clause, this escalation limits annual rent increases to one-fourth of consumer price increases rather than permitting increases to market rental rates. The leases expire in 1989. Although market rates ranged from \$20-26 per square foot in 1982, the subject property, in which leased space averaged \$15.08 per square foot in 1981, had an expected yield of no more than approximately \$16.00 per square foot in 1982.

6. Petitioner presented evidence that approximately 11 million square feet of office space was under construction and expected to be completed between 1982 and 1984, twice the amount of new office space delivered during the prior three year period. As a result of this production and a decrease in the demand for new space, in 1982 there was an oversupply of approximately 3 million square feet of commercial office space, which decreased the value of that space.

7. The petitioner further presented evidence of the property's market value as of January 1, 1982, through the testimony and appraisal report of James P. Ryan, MAI. Mr. Ryan used an income approach in determining value. Relying on the income history of the property, Mr. Ryan projected the 1982 per square foot rental income for the office, retail, storage and parking areas of the property, including those areas constructed in the leased air space. Although the

^{3/} In 1982, commercial office space leased at between \$20 and \$26 per square foot.

rental rates used by Mr. Ryan were lower than the January 1, 1982, market rates, he determined that the use of market rates would give an inflated estimate of value of the property, because an investor purchasing on January 1, 1982, would be bound by the existing leases and could not obtain market rates immediately.

8. Mr. Ryan considered the various components of the subject property's capitalization rate, including mortgage interest rates, return on equity, and the real estate tax rate to determine the property's value. The value he derived through this income approach was verified by comparing the assessment of the subject property to the assessments of comparable properties.

9. The respondent offered evidence, through the testimony of the assessor, Paul E. Spruill, in support of the initial \$18,344,800 assessment. Mr. Spruill testified that he used the replacement cost approach to determine the subject property's value.

The government did not dispute the contention that the District generally uses the income approach to value commercial office buildings for assessment purposes.

The owner of the subject property submitted income and expense forms to the District of Columbia for 1980 and 1981. This information was available to the assessor and income figures were sufficiently stable to allow an assessment based on the income approach to valuation. In assessing the property for tax year 1983, however, the assessor did not use this information. He testified that he used the income approach as a check, but no supporting documentation was provided to substantiate that contention. The respondent

offered inconsistent testimony on this point. He testified initially that he had inspected the property twice, in 1979 and in 1980. During his deposition, however, he testified that he had only inspected the building once, and further, that his inspection was limited to the interior lobby of the building. On questioning from the Court, Mr. Spruill admitted that he had never inspected the interior of the building, with the exception of the lobby area. Despite these contradictions, the Court finds that the assessor did not use the income approach to valuation in assessing the subject property for tax year 1983.

10. Similarly, on direct examination, Mr. Spruill testified that his opinion of value was based primarily on the income approach, and that he checked his valuation through the cost approach. On cross-examination, he testified that he used primarily the cost approach. In response to questions from the Court, he testified that he used the cost approach because he had insufficient financial information to use the income approach, but admitted that he had access to the income and expense statements submitted by the property owner and that those statements provided a sufficient income stream to use the income approach. At his deposition, and in answers to interrogatories which Mr. Spruill signed, he stated that he had not used the income, cost or comparable sales approach to valuation. On the stand, he testified that this earlier denial that he had used this approach -- made during deposition testimony -- was a mistake.

11. Even if respondent did use the income approach, he did not present sufficient evidence of the appropriate income, expenses, or capitalization rate for the subject

property to support its own estimate of value or to rebut the evidence presented by petitioner. For the following reasons, this Court finds the appraisal and report of petitioner's expert, Mr. Ryan, more persuasive and indicative of the value of the property.

ANALYSIS AND CONCLUSIONS

Superior Court review of a tax assessment is de novo, necessitating competent evidence to prove the matters at issue. Wyner v. District of Columbia, 411 A.2d 59 (D.C.App. 1980). The correct assessment of the subject property for tax year 1983 is the present market value for assessment purposes -- the value of benefits associated with the ownership of the property -- determined as of January 1, 1982.

The Court finds that petitioner provided credible evidence that the value of the subject property as determined by applying the income approach, is \$16,300,000 for tax year 1983. Upon review of the testimony and documentation presented, the Court concludes that income analysis was properly performed, using income and expense data that has not been disputed, thereby producing an accurate estimate of market value. An expert opinion is not alone sufficient to carry petitioner's burden of proving an assessment to be incorrect. The Court therefore turns to the evidence presented regarding the assessment itself.

The assessment at issue here is the tax year 1983 assessment, as increased by the Board of Equalization and Review, in the amount of \$20,526,888. Although the petitioner has the initial burden to demonstrate that the assessment appealed from is invalid, respondent presented no evidence to support the increased assessment. Instead, the government chose to rely on the original assessment in the amount of \$18,344,000, in order to establish value in this de novo proceeding.

Petitioner contends that the original assessment was arbitrary and excessive in violation of D.C. Code §47-801 et. seq. (1981) and the due process clause of the United States Constitution. Because statutory and factual considerations are sufficient to resolve this case, the Court need not reach the constitutional issue.

By statute and regulation, assessors for the District of Columbia are required to consider all available information which may have a bearing on the value of property, including financial considerations, replacement costs less accrued depreciation and income earning potential. D.C. Code Ann. §47-820 (1981); 9 D.C.M.R. §307.1 (1982). In assessing the subject property for tax year 1983, the assessor did not adequately consider these factors.

This Court has previously recognized, and Mr. Spruill testified, that the income approach is the preferable approach for valuing income producing properties for assessment purposes in the District of Columbia. The District has acknowledged that it normally uses the cost approach only for valuing new or unique commercial properties for which an income stream is difficult to establish.^{4/} The subject property was completed in 1979 and income and expense data were developed at the time of assessment.

^{4/} This testimony is consistent with Mr. Spruill's testimony in an appeal of the assessment on a different property where he testified that he uses the cost approach for a new building for twelve months, until the income stream is stable. Washington Sneraton v. District of Columbia, T.D. No. 3123-82 (Sup. Ct. April 29, 1983) (Slip op. at 5).

Even if the cost approach were an appropriate method of valuing the subject property for assessment purposes, the respondent did not establish that its assessment was the product of a proper application of this method. Petitioner acquired the subject property in 1979 for \$2,926,860 and improved the property with a building which cost \$7,153,977, for a total cost of \$10,080,837. Respondent's evidence did not demonstrate that the reproduction cost would exceed the \$7,153,977 cost of construction or any evidence which supports an assessment in excess of the \$10,080,837 acquisition cost.

The cost approach also is used when there is a lack of comparable sales. Although the District argued that an alternative to the income method would be proper in this case, the sales information it presented could not serve as the basis for a lawful assessment in this case.

The record cards for the subject property indicate that in performing the tax year 1983 assessment, respondent simply increased the assessment of the land. As evidence to support this increase, the government presented a list of vacant land sales. To be relevant, sales data must relate to comparable properties. See D.C. Code Ann. §47-820; 9 D.C.M.R. 307.3. Vacant land is not comparable to property which contains a relatively new twelve story commercial office building and thus sales of vacant land are not relevant to a determination of the value of the subject property. Indeed, respondent's evidence shows the average sales price of the referenced parcels was \$265 per square foot -- substantially lower than the \$365 per square foot assessment of the land of the subject property.

Petitioner's evidence has established that reliance on the sales data presented by the government would not have produced an accurate estimate of value. Furthermore, there is no dispute that the assessor had the necessary data to employ the income method. The petitioner has carried the burden of proving that the assessment was based on an inappropriate valuation method seldom used for properties of this kind.

Further, the Court finds that the assessor did not properly apply the method of valuation he selected to arrive at his assessment. Although he apparently considered vacant land sales in making his assessment, the regulations authorize the consideration of sales only of "similar" or "reasonably comparable" properties, 9 D.C.M.R. §§307.1 and 307.2 (1982). Respondent's reliance on sales of vacant land did not comply with the regulations and did not provide support for the value of the subject property for assessment purposes.

Neither did respondent's use of the cost approach comply with the applicable regulations. The regulations provide that the cost approach may be used to estimate value either by (1) adjusting the property's original cost for price level changes; or (2) applying current prices to the property's labor and material components. 9 D.C.M.R. §307.4 (1982). The assessor's failure to follow either of these methods invalidates the conclusions he reached using the cost approach.

Petitioner has established that the assessor did not comply with the regulations, did not assess the property on the same basis as comparable properties and did not properly follow either the comparable sales or cost approach in preparing the 1983 assessment. The evidence establishes that the assessment is arbitrary and excessive.

Finally, the assessor's testimony reflected significant discrepancies and a lack of supporting documentation in employing the approach used. Each case, however, must be evaluated on its own merits. After weighing all the evidence, the Court concludes that petitioner has carried its burden of proving the tax year 1983 assessment for the subject property arbitrary and incorrect. The Court finds that the market value of the subject property as of January 1, 1982, was \$16,300,000.

Although this case is a challenge to the tax year 1983 assessment only, a trial court's determination of value of taxable property remains binding on the District for subsequent tax years until a genuine reassessment of the property has taken place. D.C. v. Burlington Apartment House Co., 375 A.2d 1052 (D.C. App. 1977). Accordingly, the determination that the estimated market value for assessment purposes is \$16,300,000 is the basis for taxation for tax year 1983 and in all subsequent years until there has been a lawful reassessment of the property.

Wherefore, it is this 13th day of November, 1984,

ORDERED that the respondent shall modify the assessment record card to reflect the value of \$16,300,000 for tax year 1983 and for all subsequent years until a lawful reassessment has been performed and shall refund to petitioner the excess taxes which have been unlawfully collected for tax year 1983 and subsequent tax years; and it is

FURTHER ORDERED that the petitioner present a proposed order for refund no later than ten days from the date this Order is signed.


JUDGE IRALINE G. BARNES

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